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DEPARTMENT FOR EUR/SCE (ERIN KOTHEIMER AND YOULIANA IVANOVA)

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SUBJECT: REVIVING ALBANIAN OIL INDUSTRY MAY BE ATTRACTING RUSSIAN
INTEREST

REF: A) TIRANA 186, B) TIRANA 308

Summary

¶1. (SBU) Albania, which possesses one of continental Europe's largest oil fields and has seen promising new finds for additional oil and gas reserves, is substantially expanding its oil production through Western investment. Increased interest by foreign investors in Albania's oil sector is marked by Western oil companies' moving aggressively to revitalize Albania's once-declining production. It has also brought renewed speculation that Russian interests may be attracted to the upcoming privatization of the state-owned refining company. End Summary.

Albania's Once and Future Oil Industry

¶2. (U) Albania is endowed with considerable oil reserves which have been tapped for extraction for the last ninety years. The country's first oil well was drilled in 1918 near Vlore. In the 1920s, predictions that Albania was one of the best destinations for oil exploration after the Middle East led several prominent oil companies of the day to explore for oil in Albania, including Standard Oil, Ruston and the Anglo-Persian Oil Company. The oil industry received substantial investment during the communist regime and, although the technology employed was not the most up-to-date, production expanded to more than 2 million tons per year in the 1970s, turning Albania into a net oil exporter. In the late 1980s, despite production's dropping to 1.3 million tons per year, foreign interest in exploring for oil in Albania was renewed. In 1990, Albania was the first former communist country in Europe to open itself to Western oil companies. A total of 105 companies applied for off-shore concessions, including Chevron, Occidental, AGIP, OMW and Shell Petroleum. However, exploration results were disappointing, despite investments for both off- and on-shore that amounted to almost USD 300 million. Political turmoil in Albania and Kosovo in the 1990s, falling oil prices and the then-less-desirable heavy crude quality of oil found in the country all contributed to retard further investment. By 2000, oil production had dropped to half a million tons per year, covering only 25 percent of domestic demand.

A Small Company Prospers Where the Majors Failed

¶3. (U) A total of six petroleum agreements have been signed over the last four years for the rehabilitation of existing fields, development and new exploration. Unlike before, most of these companies are small to medium sized firms. However, they are generally more aggressive risk-takers than the major oil companies and also possess expertise in the development of small oilfields. Work in the Albanian oil sector means dealing with an industry that suffers from decaying conditions, is a source of staggering

pollution and is in desperate need of investment.

¶4. (U) One success story stands out. In 2004, Bankers Petroleum, a Canadian oil company, was granted a 25-year Petroleum Agreement (PA) for the development of the Patos Martinez oilfield in southern Albania, which with 2 billion barrels of reserves is one of the largest in continental Europe. The PA provides for equal production sharing between Bankers and the state oil producer Albpetrol, once the initial capital investment has been recovered. After a two-year study phase, Bankers started production using modern technology and extraction methods its Canadian engineers honed in Alberta's heavy crude oil fields.

¶5. (SBU) According to Bankers, it has invested more than USD 70 million over the past three years to reactivate 160 existing wells. By December 2007 the company had increased production to more than 5,300 Barrels Per Day (BPD) from 700 BPD when it arrived in 2006. Bankers plans to invest up to USD 300 million to reactivate additional wells and to develop new ones with the goal of eventually increasing production to 25,000 BPD in the next two to three years. Employing new production technology, Bankers aims to increase commercially extractable oil reserves in Patos from 10 percent today to 40 percent. The company has also set an impressive example for environmental standards in its drilling operations. (Note: Embassy representatives have visited the Patos field where Bankers' modern drilling rigs operate side-by-side with Albpetrol's aging, 1930s-era derricks. The contrast is startling and surreal. Bankers' rigs are spotless and operate surrounded by gravel painted white to highlight oil spills, of which none were in evidence. Albpetrol's derricks are a dystopian vision of creaking, antiquated equipment in tar-covered fields connected by six-foot deep canals filled with the overflow of past oil spills.)

An Albanian Oil Boom?

¶6. (U) Albania has estimated oil reserves of 429 million tons. In 2007, two new petroleum agreements were signed with the Canadian

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company Sherwood International and the Greek company Stream Oil and Gas, Ltd. for the development of another five oilfields in southern Albania. It is expected that these investments will further increase domestic production, although there are no production projections available at this time. Both companies are expected to start full operations by 2009.

¶7. (SBU) Last year Manas Petroleum Corporation, a Swiss-based oil and gas exploration company, was awarded a license to explore for oil and gas reserves in a four-block area covering approximately 780,000 acres, located along a geological fold in northwestern Albania. In January a report prepared by Gustavson Associates, LLC of Colorado was picked up by local media regarding the potential for vast new reserves of oil and gas in the north of Albania. According to the report's findings, unproven reserves hold up to 3 billion barrels of oil, including more commercially valuable lighter grades of crude, and 3 trillion cubic feet of natural gas. While the report discussed potential, not proven, reserves and assessed only preliminary data, expectations for further oil discoveries and greater production in the future remain high. (Ref A)

Private Investment Leading Oil Sector Development

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¶8. (U) Albpetrol, through existing Petroleum Agreements with various foreign oil companies, has farmed out almost 90 percent of the country's oil extraction industry. This is part of an overall government strategy to privatize the entire oil sector as the most critical step for the development of the industry. The recent soar in global oil prices is also increasing foreign interest in Albania's hydrocarbon resources and facilitating the adoption of advanced production technology to extract Albania's lower quality of crude oil in greater volumes than was possible in prior decades.

¶9. (U) The increase of domestic oil production will improve the economic viability of Albania's oil processing industry. After a failed privatization attempt in 2004 due to a lack of investor interest, the GOA has again launched an international tender for the sale of 85 percent of the shares of the state-owned oil-refining company ARMO and its primary assets of two outdated heavy crude

refineries and the country's wholesale oil distribution network. The GOA is optimistic for a successful privatization of ARMO this time. Fifteen potential buyers have expressed interest in purchasing ARMO, due in part to the fact that ARMO's refineries are uniquely suited to process heavy crude oil, which is increasingly attractive to international refiners as lower grades of crude grow more expensive and scarce on world markets.

Hungarian Proxy for Russian Lukoil?

¶ 10. (SBU) Among the 15 companies which have expressed interest in ARMO's privatization is the Hungarian oil and gas company MOL. MOL's interest has raised eyebrows due to its reportedly close ties to the Russian oil and gas company Lukoil. (Note: Citing Hungarian media sources, an Albanian daily has reported that MOL formed a 50-50 joint venture several years ago with Lukoil (which has since sold its share to Rosneft) in the Russian oil region of Zapadno-Malobalik.) There is speculation that MOL enjoys the favor of Energy Minister Ruli, a rumor that gained some credibility when Ruli, who has long been dogged by unverified corruption rumors, singled out MOL for public praise several weeks ago in connection with the ARMO privatization. A prominent Albanian oil importer who, in partnership with a U.S. refining company, will participate in the ARMO bid joined the speculation. This Albanian oilman suggested Ruli had already struck a deal with MOL, a deal he claimed has the Prime Minister's blessing although not his fingerprints. He noted that MOL is already in the Balkans, having sold its recently acquired share in Croatia's INA refining company to Lukoil. Post will closely track signs of Russian interest in ARMO's privatization and whether the GOA is committed to a fair and transparent tender in the sale of one of its last remaining state-owned enterprises. (See also Ref B.)

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